DOW THEORY LETTERS INC.

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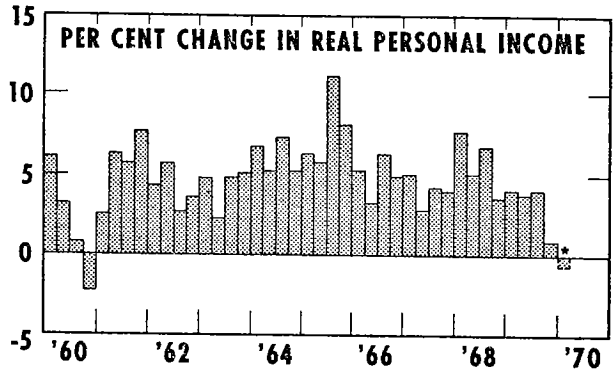
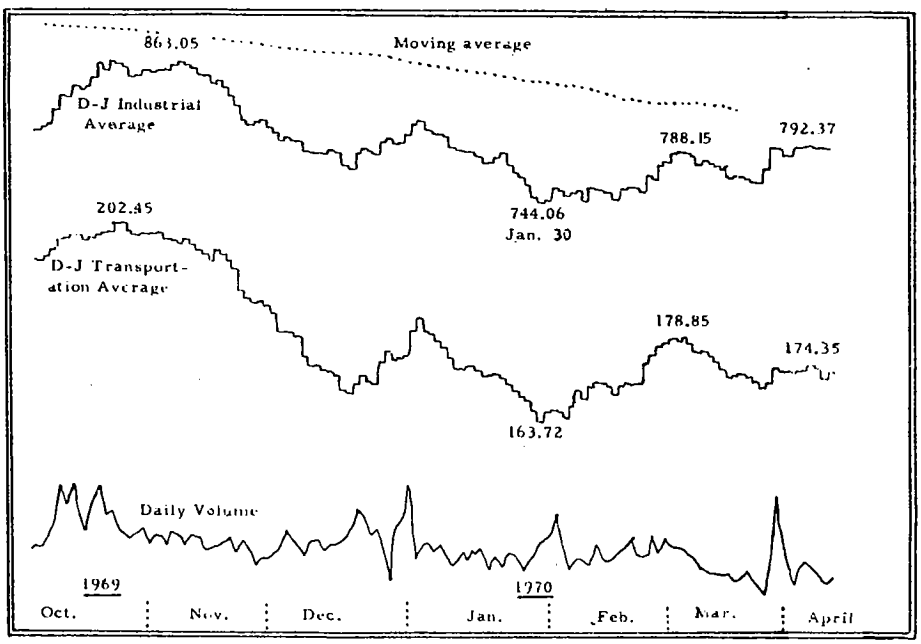
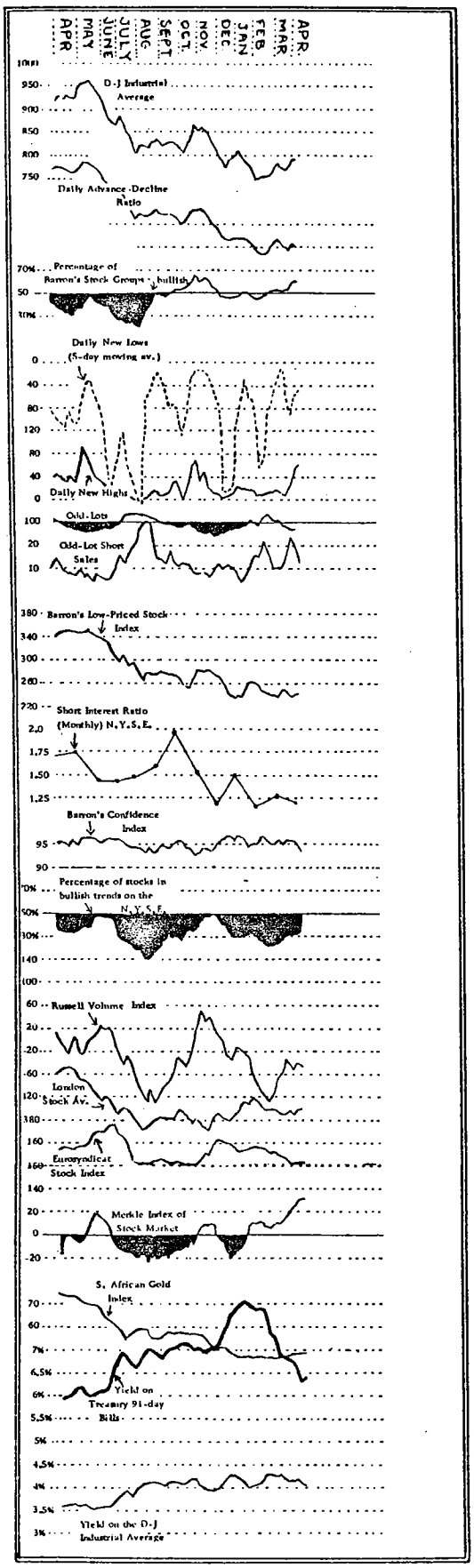
THE MARKET: Suddenly the argument is whether to call it a "recession" or not. The Administration understandably doesn't want to even hear the word, and they are now busily jazzing up whatever it is that is putting the brakes on "economic growth." Leading economists are talking about a "mild slowdown" and are predicting that the economy has already hit bottom and is now sliding sideways, preparatory to blossoming forth into expansion in the fall.

In the meantime, the First National City Bank notes that if current trends continue (see chart), the first quarter of 1970 will mark the first drop in real personal income in a decade. The drop in income is something which everybody can understand. It stems from factory closedowns, reductions in overtime and outright layoffs. "One picture is worth a thousand words," runs the old adage. And economically speaking, "A factory shutdown is a lot more meaningful to the guy who has been laid off than a thousand economic theories."

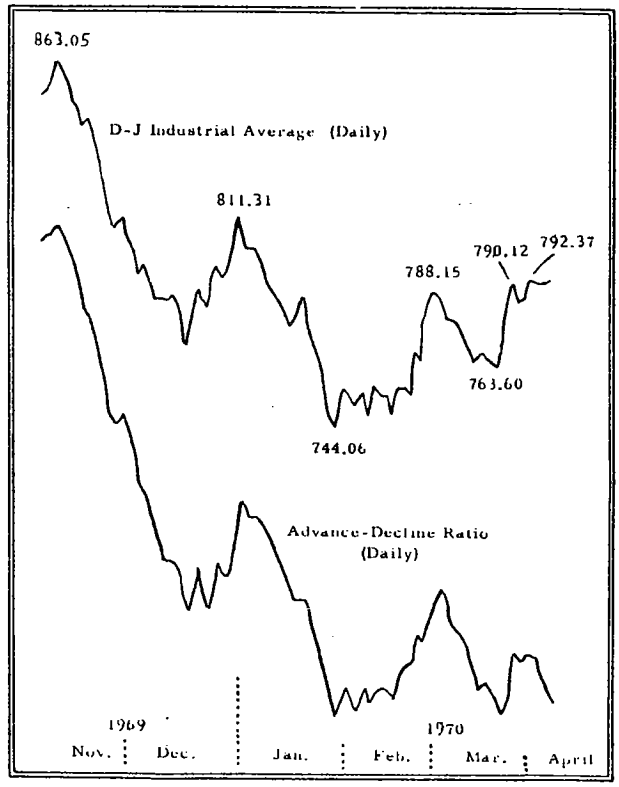
So much for economics. From the standpoint of Dow's Theory, an important non-confirmation now exists in the Averages (see chart). In early March the Industrial Average established a recovery peak of 788.15, Rails a recovery high of 178.86. Following a three-week decline, a new rally carried Industrials to a second recovery peak of 792.37 on April 2. But the new rally took Rails to 173.35 (April 3), a full four






APR. MAY JUNE JULY AUG. SEPT. OCT. NOV. DEC. JAN. FEB. MAR. APR.
D-J Industrial Average
Daily Advance-Decline Ratio
Percentage of Barron's Stock Groups bullish
Daily New Lows (5-day moving av.)
Daily New Highs
Odd-Lots
Odd-Lot Short Sales
Barron's Low-Priced Stock Index
Short Interest Ratio (Monthly) N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on the N.Y.S.E.
Russell Volume Index
London Stock Av.
Eurosyndicat Stock Index
Merkle Index of Stock Market
S. African Gold Index
Yield on Treasury 91-day Bills
Yield on the D-J Industrial Average

points under the previous high. The picture is now clear enough. Either Rails will confirm by bettering the 178.85 peak of March 5 — or trouble is in the offing. If the market turns down from here, no one can fault the Averages for having failed to flash classic warning signals.



Other indicators have joined the Averages in providing technical danger signs. In the last Letter I drew particular attention to the important non-confirmation in the advance-decline ratio (see chart). Since then, the single non-confirmation pictured in the last Letter has grown to a series of three ascending peaks for the Dow Industrials and three descending peaks for the A-D ratio. This constitutes a major divergence between the two indicators, and I have illustrated this serious technical dilemma on the accompanying chart. The chart is saying that the majority of issues on the N.Y.S.E. do not want to follow the Dow to higher ground.

The A-D ratio (which reflects the advancing or declining tendencies of the majority of issues) set a recovery peak on March 4, at which time the Dow closed at 788.15 (see chart). A decline followed, and on the succeeding advance the Dow set a new recovery high (March 25) of 790.12. The A-D ratio failed by a wide margin to confirm. A minor dip occurred, and a third recovery high was recorded by the Dow on April 2 at 792.37. Again, the A-D ratio failed to confirm. Following this ominous performance by the A-D ratio, breadth again sagged as shown on the accompanying A-D ratio chart.

It is now a question of whether the superior strength in the Dow will rub off on the rest of the market, or whether the weakness in the majority of issues will drag the Dow to lower levels. In my opinion, the A-D ratio has now sunk so far out of line with the Dow that the technical picture is all but lost for the bulls.

Last week Barron's (April 5) published a long-term study of the "20-most active stocks" index, an excellent indicator which I have referred to many times in these reports (see Letter 455). I urge all subscribers to read the Barron's piece (it starts on page 5) carefully, as I will be referring to this index constantly.

The most-active index, since August, 1968, has put in its worst performance since 1929. It is showing that the 20 most actively traded stocks are under continuing distribution. Over any given period the 20 most active stocks on the N.Y.S.E. consume about 15% of total volume. When the pleurality of those 20 stocks is in the minus column week after week, it means that the "big-volume action" is on the downside.

So far in 1970 we have had only five weeks in which the most active index was on the plus side. These were the first two weeks in 1970 and the weeks ending February 20, 27 and March 6. The most-active index turned "minus" on the week ending March 13, and it has been in the minus column ever since.

The highest figure for the index during the current 1970 rally was the plus 10 reached during the week ending March 6. This is a very weak reading for a 44 point rally in the Dow, one of the weakest on record. When the next week (week ending March 13) produced a minus 8 on the most-active index, I stated that "this could be the beginning of weakness for the rally" (Letter 455). I have not changed my opinion since then. Nor has the most-active index.

With a glaring non-confirmation in the Averages, with the most-active stock index indicating distribution in the volume leaders, with the A-D ratio reflecting weakness in the majority of stocks, I would guess that we are very close to a resumption of the primary bear trend. An additional warning note was also provided by the latest tabulation of the short interest in the 30 Dow stocks (another indicator which I cover monthly in these Letters). With a total of 586,000 shorts in the 30 Dow stocks during March, the reading for the short interest in the Dow was .61, making March the 25th out of the past 27 months in which the Dow short interest was under the critical 1.0 level.

Thus, the technical warnings are there for all my readers to scrutinize and ponder.

POLICY: Each day I receive letters asking roughly the same questions: "What do I do with my money? Should I go short, should I buy golds and silvers, should I buy Treasury bills? How about bonds? I will try to answer a few of these questions.

(1) I recommend holding 55% to 85% of assets in 91-day U.S. Treasury bills. I would open a custodial account with the bank so that your bills are kept in your own account and will not be considered part of the bank's assets. I would simply "roll over" or repurchase new bills every 91-days, and this can be done automatically by giving the bank instructions to "roll them over every 91-days and place the proceeds (i.e., interest) automatically in my account." I would stay with 91-day bills instead of six-month or any other maturity bills. Bills can also be purchased directly through the Federal Reserve Bank at auction. For information on this procedure (which is a good one), write to the Federal Reserve Bank in your area.

(2) I have recommended a hedge position of 10% to 20% of total assets in gold shares. I prefer golds to silvers since during an economic collapse the consumption of silver could fall off, whereas gold would be hoarded. Recommended gold shares include Campbell Red Lake, Dome Mines, Homestake, and the S.African holding company American South African. All of these are traded on the N.Y.S.E. In addition I recommend the S.African mining companies which include Blyvoors, Pres. Steyn, President Brand, Free State Geduld, Western Deep Levels. You might also include a few highly leveraged mines which could increase vastly in value in case of an increase in the price of gold. These include Kloof, Welkom, Western Areas. All of the S.Africans can be purchased through your broker via American Depository Receipts.

(3) The theory behind the gold hedge is simple enough. If you hold $80,000 in bills and $20,000 in gold shares, and gold shares fall in half you have lost 10% of your assets, which is not a tragedy during a primary bear market. On the other hand, if gold shares triple you will hold $80,000 in cash and $60,000 worth of gold shares in which case your assets (now worth $150,000) will have increased 50%. In other words, the potential loss is minimal, the potential hedge-gain is worthwhile.

(4) I believe that subscribers may now purchase a limited quantity of top-rated or AAA-rated bonds. I also believe that a limited quantity of U.S. Treasury bonds may be purchased. If I had to come up with a total current-position formula, I would say that the following seems correct to me: 55% of your assets in 91-day Treasury bills, 20% of your assets in assorted gold shares, 25% in top-rated bonds.

I might add that I still believe new lows will be seen in bonds, but it is only my guess. If the bond market, under pressure of a liquidity crisis, sinks to new lows then the loss on AAA-bonds and Treasuries should not be too drastic, far less than on medium to lower grade bonds. On the other hand, if we are now approximately at the lows for the bond market, the 25% in top-rated bonds should stand us in good stead with income from such bonds currently near a 100-year high.

(5) I do not believe that the great majority of subscribers can beat the market on the short side. I say this purely out of experience. When you buy a stock which is assumed to be a real value you can sit and collect dividends while you wait. You have probably purcahsed for the long-term, and if the stock does nothing for six months or a year, what of it? But on the short side you are always fighting time. Since there are no capital gains on the short side, you are trying to make a profit as soon as possible and then get out. The short seller must pay out dividends as they are declared, so that time is against the short seller. If the stock rallies after the short is put out, there is the triple-anxiety of paper loss, potential dividend costs, and money tied up when what is wanted was a quick profit. All of this militates against the short seller. A final factor against the short seller is that he finds himself committed to "hoping" for bad news. Since such hopes go against most people's nature, the short seller finds that he is committed to being a pessimist, but this attitude bothers him, since he is then hoping for the worst for mankind. It is an unpleasant psychological stance, and personally, I don't care for it. For these reasons, I have learned not to recommend the short side to the average subscriber.

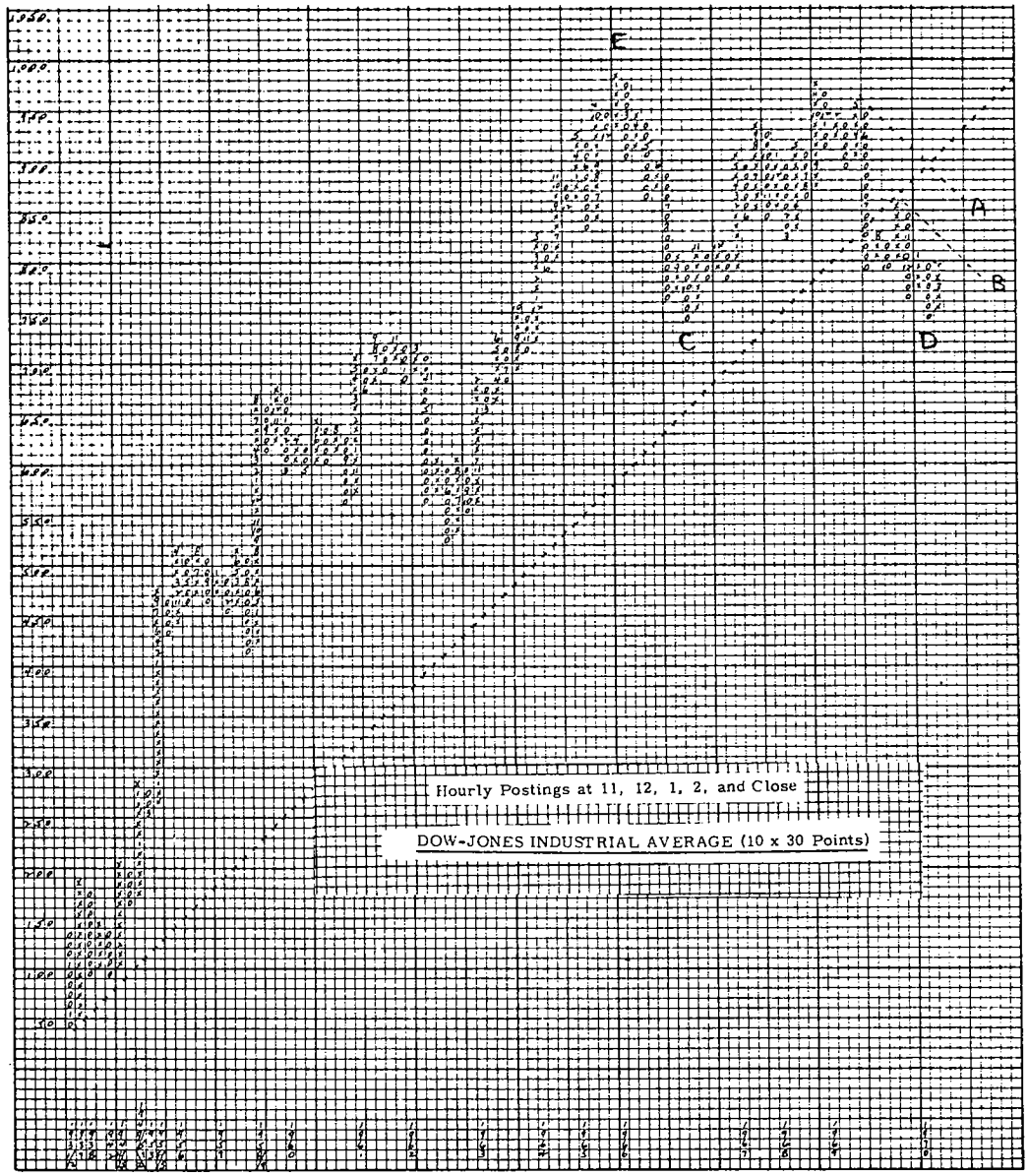
1932 TO TODAY: I publish this long-term point & figure chart on page 4 periodically in order to provide subscribers with the big picture. This chart (courtesy of Chartcraft, Larchmont, N.Y.) is a 10-point, 30 point reversal chart, which means that each box on the chart represents 10 points on the Dow Industrials and only rallies or declines of 30 points or more are shown. In other words, if the market declines from 800 for 700, then rallies to 728, no rally is shown on the chart since the move from 700 to 728 did not consume a full 30 points. If the advance then pushes to 732, three boxes upward are filled in on the chart since 700 to 732 consumes more than 30 points. All rallies are shown by vertical rows of X's, declines

are depicted with vertical rows of O's. Dates are shown at the bottom of the chart.

, mentioned in previous Letters, the decline of July, 1969 violated the long term ascending or bullish trendline for the first time since this trendline began in July, 1932. I said at the time and I continue to hold the opinion that the breaking of this 37-year trendline was an event of major importance. Since this is a primary bear market, I also stated that in my opinion all succeeding rallies would terminate below the great trendline. So far, this has been the case.

Following the 1969-70 collapse, a descending trendline (marked A on chart) was drawn. This trendline extends downward from the May, 1969 peak of 968.85. It is my guess that all rallying action from here will fall short of the A trendline, which now intersects the Dow at 890.

A second and more sensitive bearish trendline was drawn from the November, 1969 peak of 863.05 (this appears as an even 860 on the P & F chart). If the current rally were to continue it would touch trendline B at the 830 box, and my guess is that the 830 level would offer very strong resistance to any further upward progress.



At points C and D on the chart I have drawn what appears to be a massive "double bottom" at the 850-box level. These are, of course, the 744.32 low of 1966 and the January 30, 1970 low of 744.06. On this P & F chart they show as 750.

Of interest is the sheer massiveness of the pattern which has formed since the bull market top at E (995.15 on the Dow). The formation since E seems to connote great power and "solidness." I get the feeling, as I study this chart, of a huge roof which has been clamped down over the Dow.

Technically, if we take no cognizance of the direction of the primary trend, we might say that the formation since E could be either a double top or a double bottom. However, since the crux of my market philosophy is that one must at all times take into account the direction of the primary trend, I treat this pattern as a huge double top with temporary resistance at the 750 area.

As I see it, regardless of week-to-week or month-to-month fluctuations from here, the 750 points at C and D are going to be ~tacked again by the bear market. I would also guess that as and when the Dow penetrates the 740 level on the chart ...s smashing the double bottom) the impact on Wall Street and investors everywhere will be both momentous and tragic.

Technically, any close at 740 or below should set off a decline which could easily extend at least as far as the distance from E to C or 240 points. Such a decline should have no trouble carrying to around 500 and that in perhaps very short order.

OPPOSING SCHOOLS: Almost a quarter of a century ago I worked as a salesman in New York City. That was a sort of "school of hard knocks" for me, and although it was rough work, I don't regret the time I spent at it. I remember that there was one manufacturer who was using my product as fast as he could get it. He was the talk of the industry, and I couldn't understand how he could keep it up when actually business was very slow during that period (this was during the 1940's).

Then one day I went up to see my manufacturing friend, and I was amazed to see a sign on the front door saying "Closed." I asked my boss to check and see what had happened. The boss called me in that afternoon and said, "He's bankrupt." I was shaken, "How could that be possible?" I asked, "He was going like mad." My boss shook his head. "Sure, it's an old story. He wasn't using any kind of cost-accounting system, and he was undercutting the market as well as being way underfinanced. He was all volume but actually running at a loss. When he called an accountant in last week, they went over his books and told him he was broke. He was way over his head, and I understand he can't borrow a dime in today's market."

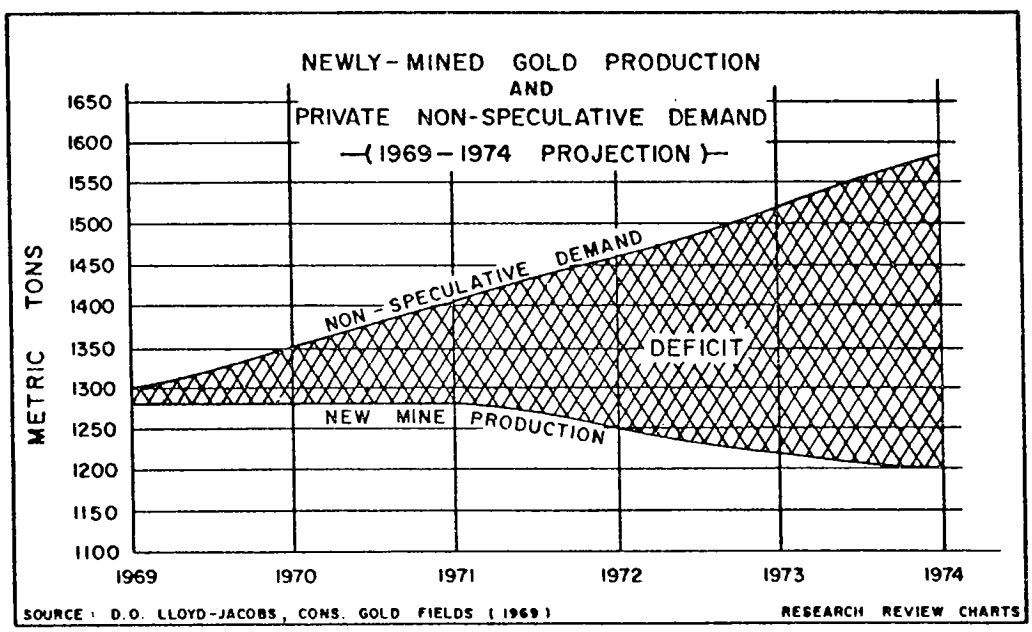
I was reminded of that tale as I read the latest issue of the authoritative Bank Credit Analyst edited by Mr. Donald Storey. Mr. Storey has been warning for many months now that his bank credit figures are flashing danger signals. His "Monetary Crisis Cycle" chart shows a series of curves which are all in the danger area. These indicators (which include bond yields, money supply, bank credit, velocity of demand deposits in N.Y.C., corporate liquidity) do not pinpoint the exact time of extreme danger. Rather they show when the economy has entered into a zone of white heat, the point of no-return. All Mr. Storey's indicators are now in the danger area, an area which can only be compared (which his charts do) to 1929.

Storey makes a most interesting observation in his current report. He notes that there are two schools of economic opinion, the "consensus school" and the "liquidity school." The consensus school is oriented to the income approach to the economy. They are steeped in U.S. productive and technological ability, and they believe in perpetual (but moderate) price inflation. They are relatively unimpressed by balance-of-payments problems and they also tend to be unimpressed by liquidity factors in the U.S. economy. In other words, the consensus school might be termed the school of "Hopes and good feeling."

The liquidity school (of which Mr. Storey is a famous and leading member) believes in balance sheets in both corporations and the economy as a whole. This school believes that the business cycle is still an ultimate fact of life, as is the theory of natural corrections and natural deflation (resulting, as they have in the past) from periods of boom.

Finally, Mr. Storey states that the most basic difference between the two schools is the refusal of the consensus school to take account of the deteriorating balance sheet of the nation. No mention is made by our leading economists of the fact that corporate liquidity is now at historically low levels. No mention is made of the possibility that a moderate recession here (in view of the low liquidity) could force many major corporations to the wall. Therefore, I would term the liquidity school the "realists." The liquidity school is not only interested in the fact that the patient is running fast, they also want to know about his blood pressure, his pulse rate and his temperature. I believe they have a point.

See page 6 →



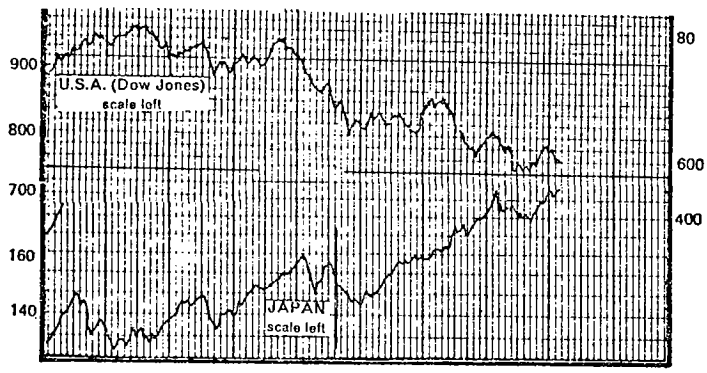
GOLD: In Letter 452 I included a section calling attention to the myriad new commercial uses for gold. With gold's unique malleable, ductile, tarnish-proof, conductive and other extraordinary qualities, industry is turning to the yellow metal in an ever-expanding way. In fact, according to William Rickenbacker's recent book, "Death of the dollar," the commercial uses of gold are expanding at a rate of about 12% per year.

Last week Research Review presented an interesting section on gold and its increasing scarcity. According to the London Mining Journal, says the review, industrial usage of gold will become an important factor in the demand situation within the next three years, and the price of gold could advance on the basis of industrial usage alone.

Economists for Goldfields Ltd. have projected figures for newly-mined gold production and private non-speculative demand, and by the latter they mean consumption in industry and arts plus purchases of gold for medium to long-term savings. Research Review placed these figures in the form of a chart, and I thought the chart was so interesting that I wanted to include it with this Letter. The chart shows a steadily widening deficit, and this on the basis of non-speculative demand. Note that the chart shows non-speculative demand currently in excess of production.

The explosiveness of the situation can be understood if we realize that any rise in speculative demand from today's "calm" levels could send the gold deficit much farther apart than the shaded area shown on the chart. This is the picture which is beginning to dawn on investors, and one can sense it as the gold shares edge gradually higher and higher above their 1969 and 1970 lows. (chart from Research Review, suite 21, 2720 Des Plaines Ave., Des Plaines, Ill. 60018).

THE RISING SUN: This little chart (courtesy of International Investor, 354 Kensington Rd., London S.E. 11) is telling a potentially incredible story. It is the story of the rise of Japan as one of the world's leading economic powers. Here are some of the unbelievable facts, facts which cause a number of analysts to feel that Japan is on its way to threatening the U.S. lead as the world's number one economic power.



The Gross National Product of Japan was $24 billion in 1955, $63 billion in 1963, estimated at $200 billion in 1970. In the past 10 years Japan's growth rate has averaged triple that of the U.S. or about 12% per year.

Japan has been the world's leading shipbuilder for the past 14 years. Over the past 10 years Japan has moved from 7th to 3rd place in auto production. Japan has become a leading steel producer and at its current rate could produce 160 million tons of steel by 1975, possibly surpassing the U.S.! Japan's exports have skyrocketed from $3.5 billion in 1959 to almost $16 billion last year.

The auto picture, one of Japan's chosen growth projects, is now becoming very interesting. Two years ago a dramatic turning point in world car production was reached. At that time, for the first time in history, the rest of the world produced more cars than were produced in North America. Much of this was due to Volkswagen, but the turning point was also a result of the amazing Japanese successes. Look at these figures: W. Germany exports 63% of its auto production, Britain exports 48%, Britain 36%, the U.S. 5%. Japan exports only 20%, since its home market is still hungry and unsatisfied.

Currently, Volkswagen dominates foreign sales in the U.S. market with sales of well over 500,000. But Toyota is beginning to challenge the Germans. In 1969 Toyota sold 127,000 cars in the U.S., a 77% increase over 1968. Now, during 1970, sales of Japanese cars continue to climb while sales of U.S. cars in the U.S. slide.

If the current trend of aggressive Japanese production, sales and inventive know-how continues, world business could be entirely different by 1975. Stated the authoritative London Economist a few weeks ago, "The same forecasters who guessed right about the trend of world car-production are now convinced that the future of the American car market, even when the hopes of steadily increasing numbers of multi-car families are included, is going to be one of replacement."